IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

No. 221

LOUIS W. GORDON, Common Stockholder of Long Island Lighting Company,

Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY, NASSAU & SUFFOLK LIGHTING COMPANY,

Appellees-Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

Replying to Brief of Securities and Exchange Commission

I

The Commission's brief challenges the *locus standi* of petitioner Gordon on the ground that he did not participate in the administrative hearings. Participation in the S. E. C. hearings is not a condition of becoming a party objectant to the Plan in the District Court. As a stock-

holder, petitioner had a statutory right to object to enforcement of the Plan. *In Re Engineers Public Service Co.,* 168 Fed. (2) 722, 731-732; see *American Power & Light Co.* v. *S. E. C.,* 325 U. S. 385, 388-391.

The Commission complains further that Gordon had "acquired his stock after the hearing was closed" but omits to state that Gordon had become a stockholder many months before the Plan was approved by the Commission and its order of approval entered.* He was, therefore, both "aggrieved" and "affected" by the Commission's order approving the Plan.

There is no claim that Gordon was a director or other fiduciary taking unfair advantage of "inside knowledge" when he acquired his stock. It is settled law that he is entitled to urge all objections to the Plan common to the class of which he is a member. *Comstock* v. *Group of Investors,* 335 U. S. 211, 226; see *Manufacturers Trust Co.* v. *Becker,* 338 U. S. 304.

In fact, Gordon is in at least as good a position as the various Committees in the case. These act under simple powers of attorney from security holders who, despite having given powers to the Committees, have been free to dispose of their holdings on the New York Curb Exchange where the stocks are listed and have been actively traded in during the five years during which the Section 11 proceeding has been pending.

II

The Commission reiterates its position (pp. 20-23) in complete reversal of its earlier practice (see Gordon peti-

* The Commission's Findings and Opinion were issued in November 1949 (R. 145). The minutes in the District Court disclose that Gordon purchased his 50,000 shares between April 11, 1949 and September 13, 1949.

tion, pp. 9-10) that the possibility that the existing equity investment will benefit in terms of incremental earnings from post-1949 expansion of plant and facilities is too "remote and speculative" to be susceptible of forecast. It does not deny that it failed and refused to consider evidence tending to show that such expansion will in fact increase the earning power of the existing equity investment. It does not deny that this has already taken place; that the company's own budget estimate of net income for 1950 exceeds the Commission's estimate of $3,500,000 by more than $500,000 (R. 935), that interim 1950 earnings are at approximately the budget rate (R. 907 and see page 11 of this brief) and that such increase in earnings is due to an enormous increase in the "rate base" which has already taken place (R. 910), viz., to the very expansion of plant and facilities which the Commission has claimed cannot produce earnings for the existing equity.

The claim that the common stock of the Consolidated Company can benefit from new construction only to the extent that it is financed by the sale of bonds and cannot benefit to the extent that capital is raised by the sale of "stock" (p. 21), is demonstrably false and misleading. The Consolidated Company will emerge from the reorganization under the Plan with only common stock and bonds. It will be in a position to sell preferred stock—a form of security of which many hundreds of millions of dollars worth are being sold by utility companies every year at a yield which leaves a substantial margin for the common, assuming a normal rate of return. And even if a part of future property additions should be financed by the sale of additional common stock of the Consolidated Company, the earnings from even such property additions will not accrue exclusively to the new common unless the new common should be sold at a price equal to the asset value

of the old common and not, as is reasonable to assume in the case of a company having, in the words of the Commission, "extremely favorable business prospects" (R. 889), at a somewhat higher price. All these were matters for experts to demonstrate and forecast, as they have done in other Section 11 cases before the Commission, but the Commission, having refused to consider evidence of this character in this case, defends a position already taken by asserting that it is beyond the possibility of proof and that a negative answer must be conclusively presumed.

In *Group of Institutional Investors* v. *Milwaukee Railroad Company,* 318 U. S. 523, 542-544, this Court held that the *wartime* earnings of a railroad are temporary in character and not indicative of permanent long range earnings on which a future earning estimate for reorganization purposes must necessarily be based. But here the rise in earnings is admittedly not due to temporary conditions but to the continuing phenomenal growth of the territory in which the Long Island System has a monopoly in supplying light, heat and power, and the concomitant necessary expansion of plant and facilities, viz., of the rate base.

III

The procedure followed by the Commission in the Court below in connection with disposing of the issue of consolidation savings of $250,000 per annum is defended as consistent with due process on the ground, adopted by the Court of Appeals, that what the Commission did in its Supplemental Findings and Opinion was to make additional findings on the existing record and—

> "a new hearing was not required any more than a new hearing would be required before a District

> Judge if we (the Court of Appeals) asked the Judge to see what findings of fact he had acted on but had not expressed in his opinion." (Commission's brief, p. 26)

There is here a misuse of the word "hearing". It may well be that a Court or an administrative tribunal to which a case is referred back for additional findings need not have a "hearing" in the sense of taking additional evidence if it decides that the new findings can be made upon the evidence already taken. But it cannot, without violating procedural due process, make new or supplemental findings without first giving notice to *all parties* that it proposes to do so and an opportunity to all of them to address themselves to the Court or administrative body, at least by argument, on the subject on which new or supplemental findings are proposed. One of the purposes of such an argument is to help the Court determine whether or not the new or supplemental findings can be made on the existing record or only after taking additional evidence. In the case at bar, the new findings were made on the basis of "representations" of the proponents of the Plan, behind the back of its opponents; without any notice that they were to be made and without any opportunity to them to be heard. While the opponents of the Plan were waiting for the remand of the case, they were confronted with the accomplished fact of new findings without a remand. That such a procedure is in flagrant violation of procedural due process is established by decisions of this Court. In *Morgan* v. *United States,* 304 U. S. 1, this Court said:

> "* * * The right to a hearing embraces not only the right to present evidence but also a reasonable opportunity to know the claims of the opposing party and to meet them. The right to submit argu-

ment implies that opportunity; otherwise the right may be but a barren one. Those who are brought into contest with the Government in a quasi-judicial proceeding aimed at the control of their activities are entitled to be fairly advised of what the Government proposes and to be heard upon its proposals before it issues its final command." (pp. 18-19)

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"* * * If in an equity cause, a special master or the trial judge permitted the plaintiff's attorney to formulate the findings upon the evidence, conferred *ex parte* with the plaintiff's attorney regarding them, and then adopted his proposals without affording an opportunity to his opponent to know their contents and present objections, there would be no hesitation in setting aside the report or decree as having been made without a fair hearing. The requirements of fairness are not exhausted in the taking or consideration of evidence but extend to the concluding parts of the procedure as well as to the beginning and intermediate steps." (pp. 19-20)*

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* The cases cited by the Commission (pp. 26-27) decide nothing to the contrary. *Federal Communications Commission* v. *WJR, The Goodwill Station, Inc.*, 337 U. S. 265 simply holds that the right to *oral* argument is not essential to procedural due process provided a reasonable opportunity to submit arguments in writing has been afforded. In *Old Colony Bondholders* v. *N. Y., N. H. and H. R. Co.*, 161 Fed. (2) 415, following an earlier remand of a railroad reorganization plan to the I. C. C. on a specific issue, the I. C. C. rendered a supplemental report and findings on such issue adhering to its original approval of the plan, without taking new evidence. But an examination of the proceedings taken before the I. C. C. (261 I. C. C. Reports 195-210) shows that before the supplemental report and opinion was issued, *all* parties had been given an opportunity to address themselves to the I. C. C. Upon consideration of all petitions, arguments and specific offers of proof, the I. C. C. issued its supplemental findings and order approving the plan and denied *inter alia* the need for additional proof.

Had notice been given of the fact that new and supplemental findings were to be made prior to remand, and opportunity to be heard thereon been afforded to petitioner, the Commission could not have, without an abuse of discretion, refused to consider evidence—later vainly proffered before the Court of Appeals—showing that due to the enormous increase in the rate base since the original findings were made, the $250,000 of admitted consolidation savings will in no event have to be returned to the consumer in the form of rate reductions nor are they needed as a "margin of safety" for the Commission's income estimate in possible poor years. It is elementary that in any proceeding which is essentially equitable in nature the rights and equities of the parties must be determined in accordance with the facts as they exist as of the time of the decree and not of any earlier time. (*Randel* v. *Brown*, 2 Howard (U. S.) 406, 423; *Stonega Coke & Coal Co.* v. *Price*, 106 Fed. (2) 411, 419.)

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The argument that the Administrative Procedure Act is inapplicable because the effective date of the Act is December 11, 1946, and the simplification proceedings in the matter of Long Island Lighting Company and subsidiaries originated in 1945, is a distortion of the language of that Act. It is true that Section 12 of the Administrative Procedure Act (5 USC §1011) provides that—

> "No procedural requirement shall be mandatory as to any *agency proceeding* initiated prior to the effective date of such requirement."

but the term "agency proceeding" is defined in Section 2(g) of the same statute (5 USC §1001) as meaning—

> "any agency process as defined in sub-sections (c), (d), and (e) of this section".

Sub-section (d) of the same section reads as follows:

> " 'Order' means the whole or any part of the final disposition (whether affirmative, negative, injunctive, or declaratory in form) of any agency in any matter other than rule making but including licensing. 'Adjudication' means agency process for the formulation of an order."

The Supplemental Findings and Opinion were the result of an application therefor filed by the companies with the Commission on June 5, 1950 (R. fols. 1918-1919). This application, and the action taken thereon by the Commission, constituted an "agency process" in the sense of an "adjudication" as defined in the Administrative Procedure Act. This "agency process" began on June 5, 1950, almost five years after the effective date of the Administrative Procedure Act. This construction not only follows from the explicit language of the Act but the contrary construction urged by the Commission would emasculate the Act and lead to an absurd result. Simplification proceedings under Section 11 of the Public Utility Holding Company Act are notoriously long-drawn out. They take many years with intermittent hearings of some days and weeks, followed by months and years of quiescence. Many of these simplification proceedings, initiated years ago, are still pending, with plans still in preparation. Conditions change, plans are withdrawn, changed, resubmitted, disapproved, etc. The "proceeding" in the sense of Section 11 of the Holding Company Act is still the original "proceeding" but this Section 11 proceeding consists of a large number of separate "agency proceedings" within the meaning of the Administrative Procedure Act. To hold that applications and petitions filed years after the effective date of the Administrative Procedure Act and resulting in new hear-

ings, orders and decisions, are not entitled to the protection of the Act would lead to an absurd, unfair and unnecessary result.

The matter is obviously of great general importance and the misconception of the Commission as to the meaning of the Act should be corrected by a ruling of this Court.

IV

The Commission argues (pp. 27-29) that no legal error was committed in first allotting to Long Island, as against Queens and Nassau, 83.7% of the total capital stock of the Consolidated Company in accordance with the Commission's finding that *all* the stockholders of Long Island are entitled to receive, after *weighing* Long Island's relative income, asset and credit contribution to the consolidation, 83.7%, or $2,929,500 of the estimated consolidated earnings of $3,500,000 per annum; and then proceeding to apportion the stock so allocated to Long Island, as between the preferred stockholders of Long Island on the one hand and the common stockholders of Long Island on the other hand, on the basis of a hypothetical future income stream allocable to Long Island of $2,815,000 only, viz., as if Long Island had received only 80.42% of the stock of the Consolidated Company (see Gordon petition, pp. 17-18). A simple illustration will suffice to demonstrate that despite all the verbiage employed by the Commission in justifying this allotment the position of the Commission does not stand analysis and that the error remains an error. Suppose manufacturing company A, equipped with very high quality assets and a very high credit rating, has a foreseeable future income expectancy of $1,000,000 a year. It has two classes of stock, preferred and common; the preferred is not in arrears and

is entitled to a fixed dividend of $1,000,000 a year. If company A were recapitalized standing alone, under a plan calling for the issue of one class of common stock only, a plan based on prospective earnings would allocate all the new stock to the preferred and none to the common.* Suppose, however, that company A merges with, or consolidates with, company B and that company B, standing alone, has a future income expectancy of $2,000,000 a year but less desirable credit and lower quality assets. Suppose further that in recognition of the fact that company A, apart from its own income, will contribute its superior credit rating and very high quality assets to the consolidation, the merger terms allocate to the stockholders of company A not 33.13% of the capital stock, being all common stock of one class, of the company resulting from the merger or consolidation, but 50%, so that 50% of the expected future combined net income of $3,000,000, or $1,500,000 per annum, will flow to the former stockholders of company A. If the Commission's argument is correct, the new stock allocated to company A under the merger terms will be apportioned as between the preferred and common stockholders of company A on the basis of a future income expectancy of only $1,000,000 and the result is that the preferred stock of A will get all the new stock including all the consolidation benefits, and the common will be eliminated. If, as we contend, the $500,000 per annum of consolidation benefits accruing to company A must be taken into account in the allocation as between the preferred shares and the common shares of company A, the common stock of company A will obviously receive some substantial participation.

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* We assume no voting control by the old common in this example which might require some recognition in allocations.

The position of the Commission on this issue shows a fundamental error and misconception of the rule of substantial equivalence as applied to reorganizations coupled with mergers or consolidations. In addition to its sweeping powers in connection with Holding Company Act reorganizations, the Commission, by virtue of its advisory functions, has a dominant influence in Chapter X reorganizations as well. The error committed in this case might furnish a pernicious precedent for future reorganizations unless corrected by this Court.

The Commission claims that this point was not covered by the formal objections filed in the District Court, nor raised on appeal and hence should not be considered now. The point was adequately covered in petitioner's Statement of Objections to the District Court which excepted to the finding of the Commission with respect to "the amount of future or prospective net income estimated by the Commission for each of the constituent companies" (R. fol. 1075) as well as to the finding that "the allocation of 5.715% of the new common stock to the old common stock of Long Island is fair and equitable" (R. fol. 1076). It was made the subject of a specific and elaborate presentation to the Court of Appeals by this petitioner (R. 914-916).

Reply to the Brief of Long Island Lighting Company, *et al.*

The company's brief (p. 8) compares the S.E.C.'s long range future estimate of $3,500,000 with the recently published consolidated net earnings for the twelve months ended June 30, 1950 of $3,687,000. It does not tell the Court that the consolidated net earnings for the six months ended June 30, 1950, issued by the company as part of the same statement, are $1,938,616, reflecting the

progressive rise of net income due to the rapid growth and expansion of plant, facilities and service in the area. This six months figure is in line with the company's own budget estimate of approximately $4,000,000 for the entire 1950 as against the S.E.C.'s permanent long range estimate of $3,500,000. And all this without a drop of natural gas which will arrive only at the end of this year.

The company also seeks to justify the S.E.C.'s future estimate on the ground of the "Korean embroilment", viz., that war conditions *might* result in decreased utility earnings. If, as this Court has held, the rise in earnings in some industries during World War II, being temporary in character, will not justify an *upward revision* in valuing the equity for reorganization purposes (*Group of Institutional Investors* v. *Milwaukee Railroad Co.*, 318 U. S. 523, 542-544), the possible temporary adverse effect on utilities of the "Korean embroilment" should not justify a *downward* revision of foreseeable future earnings for reorganization purposes.

Respectfully submitted,

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